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TAGS: ECON EFIN EINV PGOV MY
SUBJECT: MALAYSIA FEELING EFFECT OF FINANCIAL CRISIS, EXPECTS TOUGH YEAR IN 2009

REF: A. A) KL 814
¶B. B) KL 822

Classified By: Economic Counselor Matt Matthews for reasons 1.4 (b) and (d).

¶1. (SUB) Malaysia started the financial crisis with relatively good macroeconomic fundamentals and a strong external position for handling shocks to the system. GDP growth was strong, reserves were at USD 125 billion, exports were growing fast and Malaysia enjoyed a substantial balance of payments surplus. However, after the strong first half this year, Malaysia,s financial markets and the real economy have begun to show signs of stress. Growth in industrial production has slowed markedly to just 0.9 percent in August yoy, consumer confidence has dropped through the floor and key export sectors like electronics have weakened substantially. As of September 30, Malaysian forex reserves have dropped 12.8 percent to USD 109 billion as foreign funds abandon the stock and bond markets. The Bursa Malaysia stock market was down 8 percent over the past week and down 36.5 percent since the beginning of the year. CIMB, one of Malaysia,s leading banks, predicts GDP growth will slow to 3 percent in 2009 as the secondary effects of the financial crisis and ongoing global slowdown play out. So despite the fact that Malaysia maintains a strong trade surplus with exports exceeding imports by USD 27 billion January through August and a forex reserve cushion equaling a substantial 9 months of imports and 4.1 times Malaysia,s external debt position, the mood in Malaysia is one of caution and increasing worry.

¶2. (C) Central Bank Governor Zeti recently told EconCouns that she was fully supportive of efforts of the Federal Reserve and the Treasury to stabilize the U.S. financial system. Zeti commented that the moves were fully justified given the depth of the problem and her only criticism was that the USG could have moved with a broader package of measures sooner. As for the impact of the US financial crisis on Malaysia, Zeti said that unlike 1997, Malaysia had a better capitalized, more efficient and more tightly regulated banking sector which was relatively well insulated from first round effects. To date, Malaysia,s exposure has been very limited, according to Zeti, but central bank remained on high alert as more international financial firms experienced problems to ensure that local banks were not hit by counterparty risks. Zeti noted that she had been harshly criticized for intervening to support Malaysian banking institutions during the Asian Financial Crisis, but she felt vindicated now and made it clear that Bank Negara would be ready to support Malaysian banks if necessary. Zeti added that she also had been criticized at the summer BIS meetings

for refusing to raise interest rates but she said her bet that the financial crisis would create substantial negative secondary effects on Malaysia,s real economy through slowing exports and higher costs for capital justified her insistence on maintaining an accommodative monetary stance.

¶3. (C) Goh Ching Yin, the Executive Director of the Securities Commission,s Strategy and Development Division told Econcouns that the Commission was also on alert. Foreign portfolio funds had been withdrawn from Malaysia,s stock market over the past six months and the market had declined over 30 percent since the beginning of the year. The declines so far were coming in manageable increments, Goh said, but the Commission was prepared to implement its circuit breaker trading procedures if the market declined over 10 percent in a day. Like the central bank, the Securities Commission was particularly on the lookout for listed firms being hit by unexpected counterparty risks. But even if specific Malaysian firms do not come under attack, in Goh,s view, there was no way Malaysia could escape the generally negative trends the financial crisis has created throughout Asia. He expected continued weakness in the stock market because foreign funds would continue to exit and because Malaysian corporates would experience weaker demand for their products, higher costs of capital, tighter margins and declining profitability*thus keeping local punters on the sidelines.

KEITH